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April 27, 1999

MEMORANDUM FOR THE EQUIPMENT LEASING ASSOCIATION

THE TERRIBLE 2s: Revised UCC Article 2A-Leases

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Introduction

Thousands of years old, leasing has always been recognized as a distinct commercial transaction: different from sales, different from secured transactions. This is implicit in the very existence of UCC Article 2A-Leases.

Yet this important principle has received only grudging recognition in the current revisions of 2A.[1] The Committee revising 2A has proceeded by challenging the distinctiveness of leasing custom and practice, explicitly putting the burden on leasing to explain why sales law should not control all aspects of the commercial law of leasing on issues such as lease contract formation, excuse from

[1] Originally promulgated in 1988 (and revised in 1990), UCC Article 2A-leases is one of the newest parts of the UCC. It contains the basic set of state commercial law rules that govern nearly $200 billion a year in leasing transactions in the United States, accounting for nearly 30% of all capital investment in this country each year. 2A is not outdated. Nor does it need to be "revised." But many of the provisions in 2A-leases were patterned after the rules in 2-sales. One of the two co-sponsors of the UCC, the National Conference of Commissioners on Uniform State Laws (NCCUSL), felt that, since UCC 2-sales was being revised for the first time since its enactment in the 1950s, related provisions in 2A-leases also should be revised to keep these two UCC Articles in "harmony." The proposed revisions to UCC 2-sales and UCC 2A-leases are now before the American Law Institute (ALI) (the other UCC co-sponsor) for review.

contract, warranties, and remedies. What is the answer to this challenge?

Oversimplified, an intellectually elegant view of leasing is that it is the separation of ownership and possession in a lease that explains ***WHY*** commercial leasing law is different from sales law. The impact of the ownership/possession separation in a lease is felt across-the-board in commercial leasing law areas including: (1) lease contract formation rules (the statute of frauds, the parol evidence rule, no-oral-modification clauses, and support for pretransaction disclosure of terms in internet contracts); (2) lease warranties; (3) rules about excuse or impracticality of performance in a lease; and (4) true lease remedies (measure of damages, statute of limitations). In each of these areas, it is not appropriate to impose sales law on leasing. Leasing is distinctive.

Ordinarily, the statutory provisions of the Commercial Code seek to clarify and improve the law, in the public interest, to facilitate commerce. The Commercial Code generally allows "freedom of contract," providing a set of default rules (gap-fillers) that apply only if the parties make no agreement on the subject matter of the rule. These "fall back" rules should reflect common commercial practice. See Gilmore, On the Difficulties of Codifying Commercial Law, 57 Yale L.J. 1341 (1957). In the current UCC revision process, there has been a significant emphasis on inserting more "consumer protection" measures into existing law. The issues frequently involve disputes about the fairness and efficiency (i.e., the precision or overbreadth) of proposed "consumer protection" measures.[2] To some extent, the "UCC consumer protection" movement has affected both consumer and commercial law, resulting in a general expansion of liability for sellers and lessors.

UCC 2A-leases is thus being "revised" in tandem with UCC 2-sales in an unusual setting: New sales law rules are being presumptively imposed on leasing, while sales law rules themselves are being revised to give greater rights to consumer buyers and lessees. The challenge for leasing is to articulate why leasing is distinctive: What makes a lease different from a sale for purposes of the commercial law rules of contract formation, excuse from contract, warranties, and remedies? Why should the law recognize leasing custom and practice?

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[2] Overbroad "consumer protection" rules fail to target the perceived evil with precision, sweeping too broadly, generating meritless/needless litigation, raising transaction costs, and causing the price of goods and services to rise to the injury of consumers and all society. People of color, and the poor, are especially likely to pay "full freight" for increased transaction costs.

What follows is a summary of revised UCC 2A-leases as it appears in the "ALI Draft April 1999" scheduled for debate before the American Law Institute (ALI) in May 1999. To bring the issues to life, we describe the discussions at the 2A Drafting Committee meeting on March 26th and 27th in Bethesda, Maryland; as well as the discussions about 2A-leases at the American Bar Association (ABA) Spring Meeting in San Francisco this month. The issues in 2A-leases are subject to further review by a NCCUSL Harmonization Committee at the end of April. Then 2A-Leases will be reviewed by the ALI on May 20, 1999. Another 2A Drafting Committee meeting has been scheduled for July 22nd in Denver. Thereafter, several of 2A's provisions (e.g., choice of law/choice of forum; electronic commerce rules) may be switched over to UCC Article 1 and further "adjusted" there.

When asked for an overview, at the ABA Spring Meeting in San Francisco, NCCUSL Executive Director Fred Miller listed the "pros" and "cons" of revised Article 2A-Leases as follows, from the point of view of lessors:

Pros	Cons
o electronic contracting provisions (now in 2A, may be put in Article 1)	o unconscionability: expanded Official Comment
o statutory finance lease provisions modestly expanded	o parol evidence rule changed: greater latitude in allowing parol evidence
o lessees, as well as lessors, now subject to expanded definition of good faith	o implied warranty of quiet enjoyment expanded under revised 2A, to cover situations where lessor didn't cause the problem
o relationship between 2A and other law (including state certificate of title Laws) clarified	o old rules continued on lessor's required notice
o risk of loss rules modestly improved for lessors	
o warranty law on advertising clarified	
o consequential damages available for lessors	

o modest expansion of a lessor's right to cure

Our view is that revised 2A could be improved by: (1) spelling out the distinctiveness of leasing (as opposed to sales) more fully in 2A itself-- why we have an Article 2A-Leases in the first place, and why it is *not* appropriate to impose all commercial sales law rules on leasing; (2) refining warranty law principles for leasing, particularly the warranty of quiet lessee enjoyment and the law of express warranties; and (3) confining "unconscionability" more explicitly to consumer cases. The specific issues are discussed below.

I. General Provisions

A. *Definitions: statutory finance leases*. 2A-102(17). The statutory definition of a finance lease-- in which a lessor is generally exempt from warranties and is entitled to "hell or high water" rents from the lessee by statute[3]-- will be modestly expanded, in commercial (non-consumer) cases, to cover a second lease to a new lessee after the original finance lessee defaults.[4] The statutory text of new 2A-102(17) (old 2A-103(1)(g)) reads in pertinent part:

> (17) "Finance lease" means a lease with respect to which
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> (A) the lessor does not select, manufacture, or supply the goods;
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> (B) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease or, in the case of goods that have been leased previously by the lessor and are not being leased to a consumer, in connection with another lease; and
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> (C) one of the following occurs:
>
> (1) the lessee receives a copy of the agreement by which the lessor acquired , or proposes to acquire, the goods or the right to possession and use of the goods before authenticating the lease agreement; ******

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[3]The same result can be achieved by contract, without regard to 2A, by writing a lease contract to exclude warranties and to contractually specify "hell or high water"obligations for the lessee to pay rent. What 2A does is limit– to commercial (non-consumer) leases meeting certain criteria-- the kinds of leases that obtain *automatic* "finance lease" treatment *by statute*, without regard to whether warranty waivers or a "hell or high water" clause are written out in the lease. Typical finance leases both invoke the 2A statute and set out "hell or high water" contract provisions ("belt and suspenders") to ensure finance lease status.

[4]A new Official Comment to 2A-102(17) confirms that: "a finance lessor can have that status on re-leasing the property after it is returned from an original lease."

This statutory language will also permit (for the first time) a statutory finance lease to cover a Master Lease with a series of equipment deliveries over time, extending into the future, after the Master Lease is signed.

Otherwise, our understanding is that revised 2A will make no changes to statutory finance lease law. The Official Comment to new 2A-733 says that a lessee cannot revoke acceptance against a finance lessor unless the lessee has been induced to accept by the finance lessor's assurances. Accord: current 2A-516(2), 2A-517. The Comment also says that "[i]f a finance lessor has made an express warranty to the lessee under Section 2A-502 or 2A-503, revocation of acceptance is not prohibited even after the lessee's promise has become irrevocable and independent."[5]

B. *Scope of 2A*. 2A-103. The scope section of 2A will say only: "This article applies to any transaction regardless of form which creates a lease." Other provisions, spelling out whether 2A-leases or new UCC 2B-licenses will apply to a transaction, were deleted. This is because 2B has been dropped from the UCC. The ALI will not approve Article 2B-licenses this year. Instead, NCCUSL will send 2B out to the state legislatures this summer as a targeted uniform state law, to be called the Uniform Computer Information Transactions Act (UCITA). The scope section in 2-sales is also being reworked.[6] All the Terrible 2s-- UCC 2-sales,

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[5] Two other "finance lease" issues should be noted. *First*, revised 2A-606 creates some ambiguity about the rule that only lessors (not lessees) can escape from a contract by claiming "excuse" or "frustration." See p. 24 infra. *Second*, the 2A Drafting Committee rejected proposals from consumer advocates that would have outlawed "hell or high water" clauses in consumer leases. Their pitch (which was rejected) was that finance leases should be constrained by the FTC Holder Rule that invalidates "waiver of defenses" clauses and subjects lenders to all a buyer's defenses against a seller who arranges financing. See 16 C.F.R. 433.

[6] The scope section of 2-103 (sales) (May 1, 1999 Draft) presently *excludes* 2B software transactions:

> [2-103(sales)] ends the recurring disputes over whether contracts to develop or to license computer information should be treated as "transactions in goods" for purposes of Article 2. See, e.g., Micro Data Systems, Inc. v. Dharma Systems, inc., 148 F.3d 649 (7th Cir. 1998). They should not. Moreover, a transaction where a copy of computer information on a disk is sold or licensed is not within the scope of Article 2. Thus, if a person owns a computer and then buys copies of computer information for use in the computer, Article 2B applies to the copies. Article 2, however, applies to a copy of computer information "contained in and sold as a part of other goods" unless one of the two exceptions in 2-103(b) is satisfied [concerning computers, computer peripherals, and cases where access to the computer information is a material purpose of the deal] [Official Comment to 2-

UCC 2A-leases, and UCITA (formerly UCC 2B-licenses)-- will be discussed at the ALI annual meeting in San Francisco in May 1999.

C. *Transactions subject to other law: vehicles (certificate of title goods)*. 2A-105/2A-104. There has been some uncertainty about how state certificate of title laws fit together with the priority rules in current 2A-304/2A-305, covering who gets the goods when either the lessor or lessee makes a second lease of leased goods. See Comment 7 to current 2A-304. A change was made to new 2A-104(a) indicating that 2A's rules (not state certificate of title rules) will control so that a vehicle "lessee in the ordinary course of business" will win under new 2A-404(d)/2A-405(d) (current 2A-304/2A-305), if its "rights arise before a certificate of title covering the goods is effective in the name of any other purchaser." This limits the controlling effect of state certificate of title laws in some circumstances.

D. *Choice of law/choice of forum*. 2A-106. UCC 1-105 covers choice of law generally, while 2A-106 covers choice of law in consumer lease cases.[7] Hertz proposed clarification of choice-of-law rules in consumer leases: In car rentals by vacationers, for example, the parties should be able to choose the law of the State where the consumer lessee signs the lease and takes delivery of the rented car. Though this change was accepted by the Article 1 Committee, no change was made to the choice-of-law rules in the 2A "ALI Draft April 1999."

The Committee accepted ELA's proposal to clarify 2A's rule that parties to a commercial lease generally can designate an exclusive forum. The statutory text of

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103 (May 1, 1999 Draft)]

The split case law has shown a recent trend to treat software licensing as *covered* by UCC 2-sales. See, e.g., Architectronics v. Control Systems, 935 F.Supp. 425 (S.D.N.Y. 1996); Vmark Software v. EMC Corp, 642 N.E.2d 587 (Mass.App.Ct. 1994). But see Data Processing v. LH Smith Oil, 492 N.E.2d 314 (1987). Yet a recent case from the Federal Circuit suggests that software licensing, under typical conditions that materially restrict the licensee's use, is not a "sale" to an "owner" and that *federal law* (not the UCC) controls software licensing. See DSC Communications Corp. v. Pulse Communications, 170 F.3d 1354, 1999 WL 1260667 (Fed.Cir. March 11, 1999) (Bryson, J.)

[7] UCC 1-105 provides in part: "When a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or such other state or nation shall govern their rights and duties." UCC 2A-106(1) provides: "If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, the choice is not enforceable."

new 2A-106 now states that (in commercial cases) "The parties may choose an exclusive judicial forum. However, in a consumer lease the choice is not enforceable if the chosen jurisdiction would not otherwise have jurisdiction over the consumer and the choice unfairly disadvantages the consumer. A choice of forum in a term of agreement is not exclusive unless the agreement expressly so provides." [8]

E. *Unconscionability*. 2A-107. The struggles about proposed new mandatory "consumer protection" rules in the UCC have recently focused on proposals to expand the concept of "unconscionability." Traditionally, courts have required "conduct to be unconscionable in both the procedural and substantive aspects before the doctrine of unconscionability comes into play." Hawkland, UCC Series 2-302:05. "One other safeguard has been developed by the courts, namely the general refusal to apply the doctrine of unconscionability to commercial transactions in which both parties are merchants." 3A Hawkland & Miller, UCC Series 2A-108:05 (Art.2A) (1993). Both of these safeguards would be eroded by the proposed new Official Comments to 2A-107.

Early discussions in the Terrible 2s debated whether the UCC should incorporate the Restatement (2d) of Contracts 211, which strikes out "surprising terms" from a contract. This standard was roundly criticized (and rejected) because it led to arbitrary and unpredictable results; and because it simply might encourage people not to read their contracts. See Gordinier v. Aetna Casualty & Surety, 742 P.2d 277 (Ariz.S.Ct. 1986), discussed in White, Form Contracts under Revised Article 2, 75 Wash.L.Q. 315, 333-335 (1997). Cf. Ware, A Critique of the Reasonable Expectations Doctrine, 56 U.Chi.L.Rev. 1461 (1989). The Committee revising 2A voted to omit 2A-207 (striking standard terms in a consumer contract that are "materially inconsistent with reasonable commercial standards of fair dealing in contracts of this type").[9] Also stricken was 2A-207A

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[8] The Comments to new 2A-106 were carried over from old 2A-106 and unfortunately muddy the waters on this point by saying that: "This section has no effect on choice of forum clauses in leases that are not consumer leases; ....Such clauses would be governed by other law, including the Model Choice of Forum Act (1968)." That is quite wrong.

[9]Negotiations are continuing, in the 2-sales project, about "unconscionability" and 2-206 (the original prototype for 2A-207: striking standard terms in a consumer contract that are "materially inconsistent with reasonable commercial standards of fair dealing in contracts of this type"). Other issues raised by consumer representatives in these 2-sales discussions include (1) merger clauses (should they be made unenforceable, or at least not conclusive, in consumer cases?), (2) disclaimers of the implied warranty of merchantability: (a) whether categorical safe

("battle of the forms" and Gateway "rolling contract" issues)[10] since those methods of contract formation are inapposite to common leasing practice which is characterized by pretransaction disclosure of all the terms, crystallizing in a signed written deal.

We were told, at the 2A Committee meeting in March, that the "price" of omitting these "consumer protection" sections would be an expanded comment in new 2A-108 on unconscionability. As drafted by Professors Fred Miller and Marion Benfield, the proposed new Official Comment to "unconscionability" in 2A-107 contains five new paragraphs:

> "3. A particular application of the principle of unconscionability may be found in consumer contracts that involve the use of a standard form prepared by a merchant lessor and used in circumstances in which there is no expectation that the consumer will fully review the terms of the form before entering into the contract. Of course, the use of a standard form in and of itself cannot be considered unconscionable and the mere fact that a particular clause would not be exacted by the consumer is not enough to justify a finding of unconscionability. However, in that setting a term which is inconsistent with the essential purpose of the contract or conflicts with material terms to which the parties have explicitly agreed, or terms which impose unde risk or cost on the consumer under the circumstances, may be declared unconscionable by a court.
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> "In short, a term in a standard form consumer contract that might be considered to fall short of "oppression" as it was defined in *Jones v. Star Credit Corp.*, 59 Misc.2d 189, 298 NYS2d 264 (1969) (goods valued at

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harbors for disclaimers of "merchantability" (2-406) go too far; and (b) whether there should be a mandatory 30/90-day non-disclaimable warranty for cars (aka "goods subject to state certificate of title laws") worth more than $500, (3) "regulatory" approaches -- mandatory implied warranties of merchantability; limits on forum selection clauses, and (4) minimum adequate remedies– enhancing the Official Comments to emphasize this concept as an expansion of the current statutory test: whether an agreed-upon remedy "fails of its essential purpose." To the extent these issues affect commercial as well as consumer transactions, they were addressed in ELA's extensive earlier written comments to NCCUSL. We do not rehash those issues here.

[10] It is common in many settings (such as airline tickets, insurance contracts, cruise ship tickets, and computer purchases) for people to pay for products with terms to follow. The courts have upheld contracts created through this sort of "rolling contract" formation process. See, e.g., Hill v. Gateway 2000, 105 F.3d 1147 (7th Cir.), cert. denied, 118 S.Ct. 47 (1997); ProCD v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996).

$300 sold for $900 plus credit service charges), but that goes beyond an allocation of risks merely because of superior bargaining power, or beyond a term that the lessor knows might be surprising and unacceptable to the consumer, may be found to be unconscionable. For example, a standard form arbitration clause is not per se unconscionable even though the clause is surprising to the consumer and, had the consumer known of the clause, the consumer would have objected to it. But, if the arbitration clause requires a consumer lessee who is leasing furniture for $200 a month for a year to arbitrate in a tribunal which requires a non-refundable filing fee of $2000 a court could find the clause unconscionable. The result in *Brower v. Gateway 200 Inc.*, 246 A.D. 246, 676 NYS2s (1998) is instructive. There the court held that including an arbitration clause in a standard form sales agreement was not in itself unconscionable but that the particular clause which compelled arbitration in a tribunal which required an initial deposit of $4000 ($2000 of which was a nonrefundable filing fee) was unconscionable in transactions many of which involved less than $2000. Another example of a possibly unconscionable standard form is a term that allocates to the sole judgment of the lessor all decisions involving default under the lease unless the lessee establishes that the lessor willfully disregarded facts known to the lessor.

" In most cases involving an alleged unconscionable term there must be both procedural and substantive unconscionability to support relief under this section. Further, mere us of a standard form cannot be considered procedurally unconscionable: there almost always must be some affirmative procedural difficulty beyond the mere use of the form such as hidden terms in obscure print, suggesting that the consumer need not read the form, efforts to prevent the consumer from reading the form, or a false representation that the form has been approved by a governmental or consumer organization.

"However, in some cases a term may be sufficiently substantively unconscionable that it is proper to give relief even though there is no procedural unconscionability. See, e.g. *Brower v. Gateway 2000, Inc, supra*, in which the court held that there was no procedural unconscionability on the facts of that case, but that the arbitration clause was sufficiently unconscionable that it would not be enforced. See als *Dean v. Universal C.I.T. Credit Corp.*, 114 N.J.Super. 132, 275 A.2d 154 (1971) in which the court held unconscionable a clause in a security agreement which required the debtor to give notice by certified mail within five days after repossession

> if the debtor claimed that any personal articles were left in a repossessed automobile or lose any claim to such articles. The court did not discuss whether the debtor was aware of the clause or the location and size of type of the provision in the security agreement."
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> "4. In the form contract setting there is justification for finding a somewhat less than oppressive term to be unconscionable. Examples of terms which might be found to be sufficiently substantively unconscionable to justify relief might be: 1) a term in a lease that provides an exclusive remedy of repair and excludes all other relief, even consequential damages, in all circumstances, including refusal of the lessor to honor the promise of repair, or 2) a term which permits a lessor to declare a default for failure to pay even though the parties have explicitly agreed that the consumer will be protected by loss of income insurance that lessor agrees to procure and separately charges for that insurance."

We are "making new law" about unconscionability, NCCUSL Executive Director Fred Miller explained at the March 2A Committee meeting.[11] The statutory text of current 2A-108 already mentions "induced by unconscionable conduct." Fred wants a new comment in 2A that expands *substantive unconscionability* so that it is something (a) *more* than unequal bargaining power,

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[11]The original NCUSSL proposal discussed on March 26th and 27th was to rework the following single paragraph into a new Official Comment on unconscionability:

> A particular application of this principle may be found in consumer contracts, which are often characterized by the use of standard form contracts prepared by a merchant lessor under circumstances in which there is no expectation that the consumer will fully review contract terms before entering into the contract. In that setting, obscurely placed terms, or terms that are deceptive; given the overall context, and which are inconsistent with the [essential] purposes of the contract, which conflict with material terms to which the parties have agreed, or which impose undue risk or cost on the consumer under the circumstances may be [declared] unconscionable by a court: Examples of such situations are in facts in [citations]. In most cases, a finding of unconscionability is not justified unless there is some element of [both substantive and] procedural unconscionability. However, there may be cases in which a term is sufficiently substantively unconscionable that it is proper to give relief under this section even though there is no procedural unconscionability. An example of such a term may be the arbitration clause in Brower v. Gateway [citation].

See also Proposed Comment to 2-105 (unconscionability)(sales) (ALI Council Draft No.4) (December 1, 1998) (similar).

and (b) *less* than "oppression." Other phrases Fred used at various times were "substantive unconscionability light," the substance of proposed 2-206, and "inconsistent with reasonable standards of fair dealing." Some general principles were discussed in March:

> 1) Everything in the new comment about substantive unconscionability concerns standard form consumer contracts. (This would be made clearer, it was said). This special context-- standard form consumer contracts involving non-negotiated terms-- could be viewed as supplying the "procedural" part of unconscionability.
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> 2) Specific case examples will be set forth in the comment. (a) One case will be Brower v. Gateway 2000, 676 NYS2d 569 (NYSup.Ct. 1998) (court generally upholds arbitration requirement in standard terms shipped in the box with a Gateway 2000 computer, in a "rolling contract" formation process, but remands for trial on whether part of the arbitration clause-- requiring costly up-front payment to trigger arbitration-- was "egregiously oppressive" and unconscionable). White characterized the Brower case as 80% substantive/20% procedural unconscionability (i.e., Brower involved giving no remedy and not giving notice of no remedy). (b) Another example, illustrating a situation where there is no unconscionability, is a Hertz rent-a-car lease with a provision that a renter who declines Hertz' insurance will be completely liable for loss or accident damage to the rented vehicle. (c) For a variety of reasons, none of the professors (Benfield/Miller/White/Braucher) want to cite "the tomato case" cited in the comments to current 2-302 (sales). (c) Fred Miller thinks that an example of "new unconscion ability" would be shifting the risk of loss to a consumer at a much earlier time than risk passes ordinarily under the UCC. (This doesn't come up in the cases, said Fred, but one old client of his discussed this with him.) Fred will look at the federal Consumer Leasing Act, 15 U.S.C. 1667-1667e, to hunt for one or two other case examples to include in the newly expanded Comment. Others can suggest additional cases.
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> 3) The comment will state that ordinarily courts require both substantive unconscionability and procedural unconscionability before they will strike down a term in a consumer contract as unconscionable. The courts often seem to follow a "balancing approach" that weighs the amount of both procedural and substantive unconscionability. That is, a little procedural unfairness may be enough to invalidate a term that entails

> gross substantive unconscionability, and similarly a small amount of substantive unfairness may be enough to invalidate a term that involves gross procedural unfairness.

Other discussion points: (1) (White) Where full disclosure is made, and there is no "procedural" unconscionability, a court should *not* be able to invoke unconscionability. People should be left free to knowingly make a bad bargain. Hertz ought to be able to lease a car in a lease that says "No remedy exists" for the lessee. I should be able to write a valid deal that tells you up front: "NO REMEDY," or "arbitration only in Paris." On the other hand, Fred thinks that you should be able to have substantive unconscionability standing alone. (2) Issues of diminished capacity (e.g., low IQ consumer, etc) are handled under the law of capacity. (3) Braucher attacked the sentence in the draft Comment referring to "obscurely placed terms, or terms that are deceptive....." There was no particular response to the point that something from column A (procedural unconscionability) and something from column B (substantive unconscionability) both should be required. Yet Fred later said that the comment would say something about the "balancing approach" noted above. (4) Exactly how the UCC treats the Restatement 211 is important. Braucher has written that, unless the Restatement 211 test is affirmatively rejected, it can and should be read as supplementing the UCC under UCC 1-103 as a "principle of law and equity." Yet Fred Miller said in the discussion that Restatement 211 (and the "reasonable expectations test") "is gone." (5) Benfield opined that comments to the "unconscionability" sections in the UCC may bind the "new unconscionability" more than putting it into a separate statutory text. Fred said unconscionability is and always was a judicial "wild card." A comment gives more flexibility than statutory text. (6) Our comment was that the cases seem to be reaching just results under current unconscionability doctrine. (7) No change will be made to 2A-108's provisions on attorneys' fees. The opposition of industry groups in the 2-sales project to an attorneys' fees provision in 2-sales was noted.

One can make the following points about the proposed new Comments. *First*, courts seem to be reaching just results today under existing unconscionability doctrine, which "balances" substantive and procedural elements. *Second*, it is ironic that 2A should be the target of proposals to add more consumer protections. 2A is already, by far, the most liberal, pro-consumer Article in the entire UCC. One reason is that it– uniquely in the UCC– 2A has attorneys' fees provisions and the concept of "induced by unconscionable conduct" in the 2A section on unconscionability. *Third*, the most troubling aspect of the proposed Official Comment is proposed paragraph 4. It targets **commercial** as well as consumer

contracts. Traditionally, the doctrine of unconscionability has been confined almost exclusively to consumer deals, and has not been invoked in transactions between merchants. No one has pressed for expanded unconscionability in commercial deals.

There will be more discussion at the ALI meeting in May about the proposed new Official Comments on unconscionability.

II. Formation, Terms, and Readjustment of Lease Contract

A. *Statute of frauds*. 2A-201. 2A will retain the current 2A statute of frauds (2A-201), with its $1,000 trigger. Partial performance (and admissions) will satisfy the statute of frauds only to the extent of the performance (or admission) and not for a larger number of units or an alleged larger deal. As in current 2A law, a comment will say courts should address case-by-case the situation where a modification takes a deal (previously too small or otherwise outside the statute of frauds) into the coverage of the statute of frauds. Technical weakenings of the statute of frauds (emphasizing that a quantity term can be omitted from a record) are still attempted by NCCUSL, reflecting some academics' hostility toward the statute of frauds. Over many years, however, practicing lawyers have consistently supported a sound, reasonable statute of frauds.

The issues raised by the statute of frauds include the following: (1) Today the statute of frauds has nothing to do with "paper"; instead, the revised statute of frauds approves electronic "authenticated records." The policies underlying the modern statute of frauds are that parties should be encouraged to write down their deals; that some formalities are helpful to distinguish between preliminary talk and a binding deal; and that it is good public policy (and good consumer protection policy) to encourage up-front pretransaction disclosure in a record of the terms of a deal.[12] (2) Proposals to weaken the statute of frauds reflect outdated 1940s "political correctness" that was rejected by Karl Llewellyn and the original UCC in the 1950s. (3) Leasing custom and practice favors up-front pretransaction disclosure of all the terms of the deal in a signed writing (or authenticated record).

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[12]Treatises recite that the statute of frauds determines whether a deal is enforceable (i.e., the difference between preliminary talk and a binding deal), while other rules determine what the terms are. Yet practical lawyers see the statute of frauds as stimulating parties to create a record that provides a fair and efficient means of proving what the terms are, so that (hopefully) no one will have to use complex "other rules," expensive "modern trial techniques," and valuable public resources (court and jury time) to determine what the terms are in a contract.

This principle unites all our positions on contract formation law: favoring a strong statute of frauds, a meaningful parol evidence rule, and strong support for no oral modification clauses. ELA also supports this up-front-disclosure principle for commerce on the internet.[13] (4) The Committee revising 2A rejected the controversial proposal to require a person invoking the statute of frauds to "deny facts from which an agreement could be found." This proposal would have gutted the statute of frauds. It is impossible to deny the entire universe of facts from which an agreement might be found. Modern notice pleading rules (e.g., F.R.Civ.P.8) do not require a plaintiff's complaint to allege the specific facts that allegedly form an agreement; instead, a complaint can simply allege: "The parties agreed that ....." At a minimum, the proposal would have to say that a person invoking the statute of frauds should "deny facts that are specifically alleged to form an agreement." The 2A Committee voted to delete the entire concept and return to the original 2A statute of frauds. (Technical weakenings of the old rule– emphasizing that no quantity need be supplied-- are still being proposed, however.) The Committee added a new Comment to 2A-201 (statute of frauds): "Leases, more than sales, involve an often complex on-going relationship between the lessor and lessee. Therefore, it is more important that the agreement be evidenced by a writing, and a strong statute of frauds encourages the reduction of lease agreements to writing."

B. *Parol evidence*. 2A-202. Outcome: 2A-202 will conform to revised 2 with a new comment saying new subsection (b) creates no negative inference that a court can't find "intention" unless there is an ambiguity.

The Committee discussion revealed that the parol evidence rule-- thought by Professors Benfield and Miller to be too exclusionary at present of relevant evidence-- is embroiled in the "culture wars" of academia.[14] Braucher: Omitting

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[13] Other industries are different. For example, Ray Nimmer advises that the Hollywood movie industry strongly favors a "rolling contract" approach: Work on a movie is performed as contract negotiations are conducted, with a final "contract" formed only late in the process (when the likely success of the movie is more apparent, and the various parties can negotiate by invoking market pressures). Internet commerce rules should be flexible enough to support and facilitate (rather than restrict) all our different, creative patterns of commerce. Cf. Gilmore, On the Difficulties of Codifying Commercial Law, 57 Yale L.J. 1341 (1957).

[14] In the business of construing words, it is often helpful to consider more words rather than fewer words. See, e.g., Train v. Colorado Public In. Research Group, 426 U.S. 1 (1976). In a contracts context, practicing lawyers welcome "more words" and relevant evidence, but they want reliable evidence that facilitates a fast and efficient decision (summary judgment). The vagaries, time and expense of live testimony (i.e., unreliability and transaction costs) are what lead practitioners to favor written/recorded evidence over oral testimony in mine run contract

new subsection (b) would be "steroids for the plain meaning rule." White: Subsection (b) represents a proper interpretation of current law. (Old Article 2-sales changed prior law on the parol evidence rule. See Comments to current 2-202 (sales).) White doesn't like "explained or supplemented." Benfield: New subsection (b) overturns some cases. Without a comment, new subsection (b) might create a negative inference that a court can't use parol evidence to find "intention" unless there is an ambiguity.

C. *Electronic commerce*. 2A-206 through 2A-211, 2A-110, 2A-111. Oversimplified, the Committee said in March that 2A will follow 2B on "commercially reasonable attribution procedures" but will omit (and cover in a Comment) the important point that clicking an "I agree" button is sufficient to indicate agreement.[15] Technically, 2A will follow 2B's rules in 2B-113 to 2B- 120, but will omit 2B-115 (effect of requiring commercially unreasonable attribution procedure), 2B-111 (manifesting assent) and 2B-112 (opportunity to review), and will cover electronic assent issues in a Comment. This was a rushed decision, and the 2A "ALI Draft April 1999" does not fully reflect those decisions. The issues about electronic commerce rules for leasing will be revisited.

Two competing models of electronic commerce rules are being proposed in the Terrible 2s: UCITA/2B (on the one hand) and the Electronic Transactions Act (ETA) (on the other hand). ***UCITA/2B.*** UCITA/2B sets forth substantive contract formation rules.[16] UCITA/2B also provides that "commercially reasonable attribution procedures" are entitled to presumptive validity, shifting the burden to

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cases.

[15]Yet in fact the 2A-leases "ALI Draft April 1999" says nothing about clicking an "I agree" button. ELA generally agrees with the ALI Council that, in internet contracting, there should be pretransaction disclosure of the terms of the deal (i.e., opportunity to review the terms) before valid consent can be given. Accord: 2B/UCITA (failure to make pretransaction disclosure triggers right to cancel the deal and get a full refund including costs of returning the goods). We would not agree with the European Union proposal that a "triple click" (or even a "double click") is required before clicking an "I agree" button constitutes valid consent. Transaction costs might be multiplied unreasonably by a rule saying "no valid consent" without "multiple clicks" or an off-line print-out of a contract.

[16] UCITA/2B's substantive rules require an opportunity to review the terms of a deal, before an electronic contract can be validly made. UCITA/2B follows the Restatement (2d) of Contracts, defining "consent" as "manifesting assent" by conduct (or inaction) that, objectively, would be understood by the other party to the deal as showing agreement. (This would mean that clicking an "I agree" button, after opportunity to view the terms, is valid consent.)

the sender of an electronic message to prove that an interloper in fact sent the electronic message. Consumer critics of UCITA/2B complain that this puts an unfair burden on consumers to "prove a negative"-- that they didn't send a message. They also complain about UCITA/2B's provisions that, even if a consumer didn't send a message, the consumer still can be held liable if she was negligent in allowing a message to be electronically sent that appeared to come from the consumer. ***ETA.*** By contrast, ETA is a procedural statute essentially saying: authenticated electronic records (which are retrievable in perceivable form) can't be denied legal effect simply because they aren't old-fashioned signed writings. The scope of ETA excludes wills and other types of transactions,[17] but otherwise applies its "procedural" law across-the-board.[18] ETA does not deal with substantive contract formation requirements like "manifesting assent" and pretransaction availability of contract terms. Nor does it set rules for "attribution." Instead, ETA leaves "attribution" questions to the courts and the common law: You can prove attribution in any reasonable way.

Three objections were articulated at the March 1999 meeting to having 2A adopt 2B's rules on "manifest assent"/"opportunity to review." ***First*** (White) "Autistic consent" never communicated to the other party in a deal should not be valid consent. Yet Nimmer/Ring confirmed to White that 2B intends to validate "autistic consent." We and others then pointed out: "Autistic consent" is very narrow and hypothetical ("You agree that, if you go into your closet tomorrow, you agree to my terms.") It should not cover software that can only be used by clicking through "I agree" buttons (even if this clicking is never communicated to the other party at the time of clicking). Software/clickware seems more like a coin-operated vending machine selling cokes and snickers bars, than "autistic consent": The software licensor knows in advance that the licensed software can only be used if the "I agree" buttons are clicked. This sort of advance notice or assurance is a kind of communication between the parties. It makes the software case different from the "going into your closet" case. White's article on "autistic consent" will soon appear in print. ***Second***, Benfield/White/ Miller questioned more generally

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[17] Transactions coming within UCC Articles 3,4,4A,5,7,8 and 9 are wholly or partially excluded from ETA.

[18] Though it is "only procedural," ETA has a more general, broad scope than UCITA/2B. Thus, for example, ETA provides that (1) notarization can be done electronically; (2) electronic records cannot be excluded from evidence simply because they are in electronic form; (3) when electronic records are involved, a contract is formed at the time the record is received (a different rule than the one applicable to mailing old-fashioned paper writings); (4) "transferable records" are defined as the electronic equivalent of documents of title.

whether 2B's "consent" rules were appropriate for situations (sales, leases) where agreements are commonly made face-to-face, as opposed to on-line. Some litigation might arise under an "opportunity to review" standard about the validity of Hertz rent-a-car agreements where people stand in line and commonly sign the standard form lease without reading. Benfield asserted that 2B's opportunity to review rules dragged in the Gateway "rolling contract" issues that were voted inapposite to leasing. ***Third***, Fred appeared to agree with Bion Gregory's rejected motion in 2-sales about the desirability of preserving some consumer protection rules (special paper record rules) that might be wiped out (subject to being specifically identified and restored) by an across-the-board rule that "authenticated record" is as valid as a "signed writing."

Our assumption has long been that 2-sales and 2A-leases would follow 2B-licenses on electronic contracting issues. NCCUSL's pre-March-meeting memo asserted that 2A would follow 2-sales on these issues. There was only a little discussion about whether 2A should omit altogether any rules about electronic contracting. (White and Benfield opined that it was too early to try to codify rules for electronic commerce-- practice was insufficiently developed, we might get it wrong. Thirty states, says Ray Nimmer, already have laws saying that electronic signatures satisfy "signed writing" requirements, and the other states don't need them (see UCC 1-201(39)), so this is really a moot point.)White's view was that electronic contracting provisions are important for credit cards, wire transfers of funds under UCC Article 4A, and UCC 2B information licensing (where money/value is exchanged instantaneously) but are not significant for most sales/leases where commonly the making of the agreement does not instantaneously result in a shift of money/value. Nothing was decided about the Nimmer/Ring proposal for pretransaction disclosure of terms in internet transactions. Braucher said it was inadequate, but she did not suggest any specific improvements.

Given the choice between 2B rules and 2-sales rules for electronic contracting, 2A decided to adopt 2B's rules at the March meeting. Leases commonly involve more complex, multifaceted, on-going relationships than sales. Tradition, custom and practice support more structured lease contract formation rules for leases than for sales. Arguably, 2A-leases is more compatible with 2B's electronic commerce rules, which are more structured and provide more guidance (and are more "regulatory") than the de minimis electronic commerce rules of 2-sales/ETA. Outcome of the March 2A meeting: 2A will adopt 2B- 113 through 2B- 120 (except 2B-115) and will cover in a Comment the important point that clicking an "I agree" button (as in a Hertz rent-a-car on-line deal) is valid assent to a lease

contract as a matter of common law. But these issues are going to be revisited by the ALI and by the 2A Committtee at a July 22nd 2A meeting in Denver.

The only interest of ELA is in adopting sound principles of electronic commerce. We have asked ELA's 2B Committee, the ABA Subcommittee on Leasing, and the attendees at the ELA Lawyer's Forum, for their views: Which electronic commerce rules are best suited for leasing, in the public interest? The choice for 2A seems to be between (1) the "minimalist" or "procedural" model in 2-sales/ETA, and (2) the 2B/UCITA model, which sets out some substantive rules and which is now in the most current draft of 2A-leases as described above. NCCUSL will send out the ETA to the states for adoption at the same time that 2/2A/UCITA are sent out. The on-going project on Article 1 eventually may put all electronic commerce rules in Article 1. The issues about electronic commerce rules for leasing will be discussed further.

III. Construction of Lease Contract

A. *Modification, rescission, and waiver*. 2A-302. The Committee followed 2-sales by deleting "Except in a consumer lease" from new 2A-302. There was a discussion about the new requirement for waiver of no-oral-modification-clauses (NOM clauses): "A party whose language or conduct is inconsistent with the [NOM] term is precluded from asserting the term if the assertion is unjust in view of a material change of position in reliance on the language or conduct." Though different industries may feel differently about how easy it should be to "waive" a NOM clause (at common law, before the UCC, NOM clauses were unenforceable), ELA would favor ratcheting up the standard for waiver of a NOM clause.

Overall, Professor Bob Hillman (a critic of NOM clauses) seems right that current law is unclear about the standards for waiver of NOM clauses, that leaving this standard up to the courts with no statutory guidance is not a good idea, and that "section 2-209 should contain clear language delineating precisely when NOM clauses are unenforceable." See Hillman, Standards for Revising Article 2 of the UCC, 35 Wm & Mary L.Rev. 1509, 1524 (1994)). See, e.g., BMC Industries v. Barth Industries, 160 F.3d 1322, 1332-1334 (11th Cir. 1998).

New 2A-302(c) seems to say that other terms (other than NOM clauses) can be waived under a general totality-of-the-circumstances test, though waiver can be retracted "unless the retraction would be unjust in view of a material change of position in reliance on the waiver." Under new 2A-302(b), the "bar is set higher" to waive NOM clauses; they stand in place unless the "new requirement" is met

and the "new requirement" is harder to meet than the totality-of-the-circumstances test for waiver of other terms (other than NOM clauses). This statutory structure seems to make sense. Cf. Posner, J., in Wisconsin Knife v. National Metal Crafters, 781 F.2d 1280 (7th Cir. 1980). An additional Official Comment might be helpful.

B. *Risk of loss*. 2A-306; current law 2A-219, 2A-220. New revised 2A-306 combines old 2A-219 and 2A-220[19] and states "gap-filler" rules that apply when the lease agreement does not spell out "risk of loss" rules. This section was never discussed at an open 2A Drafting Committee meeting; it simply follows along with revised "risk of loss" rules in new 2-612 (sales).

Current law 2A-220 sometimes shifts the risk of loss to a defaulting party. New revised 2A-306 is somewhat different: As stated in the Comments to new revised 2-612 (sales), the

> "underlying theory of this section is that risk of loss passes to the buyer at a stated point in time based upon assumptions about who is in the best position to prevent the harm to the goods or to insure against that harm regardless of who has title to the goods or who has a property interest in the goods and regardless of whether either party is in breach of contract except for the limited circumstances in subsection (c). Thus the conformity or nonconformity of the goods to the contract is not relevant to the passage of the risk of loss for the goods except as provided in subsection (c). Whether one or both parties have insured against the loss is not relevant to determine who has the risk of loss for the goods."

As in current law, the proposed new "risk of loss" rules for leases provide that "In the case of a finance lease, risk of loss passes to the lessee." New 2A-306(a). One drawback of the minimalist Comment to 2A-306 (leases) is that it invites courts and practitioners to look at the Comment for 2-612 (sales), which states that "Of course, the obligations of either the buyer or the seller may be excused in an appropriate case under sections 2-714 through 2-717 on excuse." That principle would be misleading and inaccurate for leases.

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[19] This means that, contrary to its Comment, new revised 2A-306 does deal with responsibility for loss caused by the wrongful act of either the lessor or the lessee. Though ELA asked that all the Comments be published up-front (pretransaction disclosure in a record), none of the Comments to revised 2A were disclosed by NCCUSL until late this month.

IV. EFFECT OF LEASE CONTRACT

Alienability of lease interests. 2A-403; current law 2A-303. This important 2A section on assignment of lease interests (as when a lessor assigns the rental stream to a third- party financer), in new 2A-403, is moved in part in new 9-407, which states the law more clearly. All the Official Comments of old 2A-303 will be carried forward into new 2A-403. ELA wrote to NCCUSL's Style Committee asking for an improved "plain English" statement of the law: Generally, a lessor may freely transfer its interests in the rental stream and the residual, notwithstanding an "anti-assignment" clause; on the other hand, an anti-assignment clause will bar the lessee from transferring its interest. Cf. Comments to new 9-407.

V. WARRANTIES

The Committee revising 2A accepted -- to some degree -- ELA's point that lessors ordinarily do not produce "owner's manuals" or instructions accompanying the goods. Nor do they commonly engage in "mass advertising" touting the quality of leased goods. A new Official Comment to new revised 2A-501 explains:

> "Article 2A has not adopted Article 2 Section 2-408. That section, titled Express Warranty Obligation to Remote Buyer and Transferee, is based on the assumption that many sellers advertise to remote buyers, or include statements which are express warranties in materials accompanying the goods which are to be delivered to remote buyers. That section addresses the liability incurred to remote buyers and lessees when advertisements or materials accompanying the goods create express warranties. There seems to be no present practice of remote lessors engaging in the conduct covered by 2-408. Therefore, a similar provision is not included in this article. Section 2-408 itself gives rights to remote lessees against remote sellers that were in the chain of distribution to their lessor. If any practice develops in the future of lessors engaging in conduct like that covered by Section 2-408, it would be appropriate to apply that section by analogy to such lessors. (2A-508 is the analog of 2-409, not 2-408)."

A. *Warranty of quiet enjoyment*. 2A-502; current law 2A-211. The Committee retained proposed 2A-502, which expands the lessor's implied warranty of quiet enjoyment to guard against interference from any source (not just interference that is traceable to the lessor's acts, as in current law). Current law 2A-211 had meaning in situations like Bancorp Group v. Michigan Conference of Teamsters, 231 Mich.App. 163, 585 N.W.2d 777 (Mich.Ct.App. 1998) (court finds

violation of 2A-211 implied warranty of quiet enjoyment, where lessor allowed its creditor to repossess leased equipment from lessee that was paying rent and was in compliance with lease).

Our ELA comments agreed with Benfield that a lessor's own acts should not create a "cloud on the title" or subject a lessee to the risk of litigation about the right of a rent-paying lessee to use the goods. But ELA has asked that the statutory text and Official Comments of 2A-502 make it clear that a lessor is not responsible for safeguarding the lessee's "quiet enjoyment" against the consequences of *the lessee's own acts or omissions* (e.g., a city "boots"a rented car for the lessee's failure to pay parking tickets; or a mechanic's lien is asserted against a leased ship for unauthorized "improvements" ordered by the lessee; or a state impounds a leased airplane because the lessee used it in illegal drug smuggling operations).

No lessee should be allowed to sue and recover damages from the lessor in such circumstances. To read revised 2A-502(a) otherwise would be contrary to "principles of law and equity" (UCC 1-103) and principles of good faith (new 2A-102(a)(15)). This issue will be raised before the ALI.

Our interpretation of other parts of proposed revised 2A-502 is that a lessor warrants the lessee's quiet enjoyment against only "a colorable claim to or interest in the goods"-- which is not held by a third-party thief.

B. *Express warranties to lessee*. 2A-503. The Committee thought it was too late in the UCC revision process to adopt White's Tulane law review article as the law of express warranties in new 2A-503 or in Article 2-sales. Yet there may be motions made at the upcoming ALI annual meeting in May 1999, to simplify and clarify the law of express warranty in the Terrible 2s (2, 2A), essentially by adopting the substance of Jim White's Tulane law review article. See White, Freeing the Tortious Soul of Express Warranty Law, 72 Tulane L.Rev. 2089 (June 1998). Oversimplified, this involves grouping express warranties into three categories: (1) those that are simply terms in a contract (plaintiff need show no special reliance to sue upon them); (2) owner's manuals and instruction booklets that are not part of the contract, but are delivered with the goods and are *intended* to be relied upon (plaintiff need show no special reliance here; note that owner's manuals are commonly made by manufacturers and suppliers, not lessors)[20]; (3)

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[20] UCITA/2B aficionadios are concerned that this rule may not fit software: Software is often experimental, so that (the argument goes) it is unreasonable to hold software "owner's manuals" or "instructions" to a standard of 100% accuracy. One would think that software

mass advertising (this is a tort claim and here plaintiff's prima facie case should be required to show that plaintiff saw the ad, relied upon it, and was injured).

Though each of the law professors at the 2A Drafting Committee meeting was asked about this point very specifically, none of them objected to White's proposed clarification of the law. (Benfield's only comment was that I should be sure to make the motion for 2-sales as well as 2A-leases.) NCCUSL Commisisoner Curtis Reitz, like Professor White, has said that UCC express warranty law does not fit lawsuits based on mass advertising. Cf. Reitz, Manufacturers' Warranties of Consumer Goods, 75 Wash.L.Q. 357, 389-390 (1997). However, at the American Bar Association meeting in San Francisco earlier this month, the following objections were voiced to revising 2A and 2 to adopt White's views: (1) The warranty sections in 2-sales were "intensely negotiated" and "a balance was achieved" so that (whatever the substantive result was) it should be adopted in both 2 and 2A. (2) Professor Rush (co-reporter for 2-sales) disagrees with White about what the cases hold, saying that "reliance" is not required by current case law. (3) Advertising is intended to be subliminal, so that it is unfair to ask a consumer to point with specificity to an ad that she relied upon. Moreover, it shouldn't matter whether a consumer read an ad or not. If an inaccurate ad is issued, and a consumer suffers harm arguably related to the inaccuracy, then the burden should shift to the advertiser to show that the consumer did not read the ad or that the ad did not cause harm. (4) Consumer advocates want to change law and society, and think it is not desirable to try to clarify express warranty law by categorizing express warranty claims as either contracts or torts.

This issue may be raised at the ALI annual meeting in May.

C. *Warranty disclaimers*. 2A-506. The Committee revising 2A said that it was declining to adopt any mandatory, non-disclaimable warranties. The project on 2-sales deleted mandatory, non-disclaimable warranties (Alternative B to new 2A-506). Though Braucher and I supported adding a new "plain English" alternative safe harbor to the list of alternative safe harbor disclaimers, the Committee declined this invitation. The Committee wanted to retain the qualifier "unless the circumstances indicate otherwise" on "as is" disclaimers in new 2A-506(b)(1) (as in current 2A-214(3)(a)). It deleted the word "conduct" from 2A-506(b)(1) (disclaiming implied warranties by "conduct" --e.g., tearing up the paper or shaking one's head "no"), while leaving in new 2A-506(b)(2) (warranty disclaimer by course of performance, course of dealing, or usage of trade) as in current 2A-

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instructions could be written with appropriate disclaimers. But this issue will be left to UCITA.

214(3)(c).

D. *Extension of express or implied warranties*. 2A-508. The Committee overruled our objections and voted to keep in new 2A-508 (replacing current 2A-216), taking the brackets off the language "In a consumer lease" at the beginning of new 2A-508(a). The stated reason was that this was compelled by conformity with the 2-sales project. White said that the phrase "the operation of this section may not be disclaimed, modified, or limited unless the lessor has a substantial interest based on the nature of the goods in having a warranty or a remedial promise extend only to the immediate consumer lessee" was "a gift" to industry, giving it something it didn't have now (i.e., the ability to limit warranties in some cases to only the initial lessee). Benfield's pitch was that: (1) 2A does not adopt new 2-408 (which deals with express warranties directly to remote lessees), and (2) 2A has limited new 2-409 (sales) to family/household (eliminating the choice among three alternatives that appears in present 2 and 2A) so that in this one respect, new 2A-508 "cuts back on third party rights in those states which chose Alternatives B or C of [current] 2A-216."

VI. Performance of Lease Contract

Lessee "excuse" and "frustration of purpose". Our ELA comments repeatedly stressed that the 2A statute (new 2A-605/2A-606, old 2A-405/2A-406) should not suggest that a lessee might escape from its lease obligations by claiming "excuse" or "frustration of purpose."[21] Yet this point is clouded by revised 2A.

The statutory text (in new 2A-606) is changed from referring to "*the lessee*" receiving notice of the lessor's delay, to "*a party*" receiving notification of a delay in performance. That change in the statutory text makes ambiguous the Comment to new 2A-606 (carried forward word-for-word from old 2A-406). The ambiguous Comment in new 2A-606 says that

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[21]The very act of selecting a lease term (an inescapable necessity in any lease) represents a conscious choice by the lessee about the scope and length of its undertaking. This puts leasing (as opposed to sales) outside the rationale of Comment 9 to old 2-605 (sales)-- that a buyer might be able to escape a sales contract, on ground of "frustration of purpose," when unforeseen events destroy "a definite and specific venture or assumption" that is a basis for the contract, which was not covered explicitly in the sales agreement but which all the parties knew about. Moreover, it would wreck havoc with lease financing (where long-term deals are priced and handled very differently from short-term deals) to allow lessees to escape their lease obligations by claiming "frustration of purpose."

> [2A-606(a)(1)] "allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-604 and 2A-605)."

The original meaning (now clouded) is that the lessee could terminate the lease because of *the lessor's* excused performance. The implication of the Comment language in new 2A-606(a)(1) might be that a lessee can escape from its lease obligations by claiming lessee "excuse." This would be contrary to sound public policy, and disasterous for the leasing industry.

The Comment to 2A-606, as it stands, seems to invite error by courts addressing these issues in the future. It might be fixed by amending the Comment to read that new 2A-606(a)(1) "allows the lessee under a lease, including a finance lease, the right to terminate the lease because of the lessor's excused performance (Sections 2A-604 and 2A-605)." This issue will be raised at the ALI.

VII. Default

True lease remedies and measure of damages are different from sales law, essentially because of the lessor's residual interest (which exists because of the separation of ownership and possession in a lease). In a lease, the lessor owns the goods, while the lessee has only an interest in using the goods for a limited time. Oversimplified, the impact on measure of damages is that, in general, a lessor's damages for the lessee's breach are equal to lost rentals plus any damage to the residual; while the lessee's damages for breach are the extra rental expense of renting substitute goods.[22] These are very different from sales remedies.

Years ago, in the 1960s and 1970s, courts often confused lease remedies with sales remedies. When the lessee defaulted, and the lessor repossessed and sold the equipment and sued the lessee for a deficiency, some courts mistakenly credited the lessee with the entire sales proceeds in calculating the lessee's deficiency. See DeKoven, Leases of Equipment: Puritan Leasing Co. v. August, A Dangerous Decision, 12 U.San Francisco L.Rev. 257 (1978). This credited (or "gave") the

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[22] This is oversimplified, of course, since tax losses and other damages often may exist. For example, a lessee may seek damages if the lessor breaches duties in addition to supplying the goods, such as repairing and maintaining the goods. See current UCC 2A-103(1)(g) Comment. Often the lessor's greatest concern upon breach by the lessee is recovering possession of the goods. And a lessor often incurs incidental damages in the form of costs incurred to sell or relet the goods after repossession.

lessee the value of the lessor's residual. And that is quite wrong.

Our view is that revised 2A misses the opportunity to clarify and simplify the law by explaining these basic points about leasing, in the public interest, to help courts and practitioners reach just results. This issue will be raised at the ALI.

A. General

1. *Notice after default*. 2A-703. ELA urged, and the 2A Drafting Committee recognized, that established 2A law, and leasing custom and practice, is that notice of default generally is ***NOT*** required. See, e.g., revised 2A-703, revised 2A-704; old 2A-502. Some additional recognition of this principle occurred after the last 2A Committee meeting in March. This is one of many basic principles that make the commercial law of leasing different from sales law.

We point out that current 2A-leases contains a number of specific "notice" requirements. See 3A Hawkland & Miller, UCC Series 2A-502:01.[23] A lessor must still give notice to cure (new 2A-729), and cure is a predicate to enforcement of the lease by the lessor when the lessee has validly rejected. That seems reasonable.

2. *Consequential damages*. 2A-707. New revised 2A entitles lessors (as well as lessees) to consequential damages. The impact is de minimis since the only "consequential damages" envisioned for a lessor consist of the interest on a bank loan necessitated by the failure to obtain rentals from a broken deal. This minor "gift" to lessors in no way justifies allowing lessees to escape their lease obligations by claiming "excuse" or "frustration of purpose." See 2A-605, 2A-606 discussion above.

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[23] "Article 2A, with few exceptions, does not require notice of default or enforcement from the aggrieved party to the party in default.[2A-502] Interestingly enough, the principle exceptions are on the lessee side and include notice of set off [2A-508(6)], rejection [2A-509(2)], default and suit [2A-516(3)], and revocation of acceptance [2A-517(4)]. On the lessor side, notice to cure is required [2A-513], and cure is a predicate to enforcement of the lease by the lessor when the lessee has validly rejected, and notice to enforce a crate and deliver clause [2A-525(2)] and to stop delivery [2A-526(3)] are necessary to invoke those remedies. Finally, notice is indirectly required in several situations related to remedies upon default [see 2A-507(3) on offered evidence of market rent; 2A-510(2) on reinstatement absent notice; 2A-514 on waiver of lessee's objections absent notice; 2A-528(1), 2A-529(1)(a) on tender of possession]." 3A Hawkland & Miller, UCC Series 2A-502:01 (Art. 2A).

3. *Specific performance*. New 2A-708. Traditional equity principles for specific performance (and equity injunctive relief) would recognize that a different calculus of equities exists in each of the following different cases: (1) "Debtor's prison" (barred by statutory text of new 2A-709(a)); (2) European laws favoring "specific performance"; (3) suits for child support from "deadbeat dads"; (4) lessor's specific performance action for rent and other things (allowed by new 2A).

4. *Liquidated damages*. 2A-710; current 2A-504. The statutory text of new 2A-710, on the validity of lease liquidated damages remedies, is clarified to emphasize that new 2A-710 (old 2A-504) validates formulas or amounts that are reasonable in light of the predicted loss, measured at the outset of the lease.

5. *Contractual modification of remedy*. New 2A-712 will retain present law (current 2A-503) and not opt for revised Article 2's version (i.e., Alternative B to new 2A-712 was rejected). The vote was very close. Turning to reason (not authority), White argued: New Article 2-sale's version (Alternative B to new 2A-712) reflects a misinterpretation of a comment by Llewellyn. Moreover, new 2A-712(b)(2) (the 2-sales-derived Alternative B) is irrational: If you write a contract (K) that says: "UCC remedies apply, but consequential damages are disclaimed" that K is valid and effective; yet if you write a K that limits remedies and disclaims consequentials, and the limited remedy fails of its essential purpose, then under the 2-sales-derived Alternative B in a consumer lease you get UCC remedies but the excluder of consequentials is struck down. This makes no sense. Fred Miller: This issue should not be important because, as a matter of common commercial practice, every limited remedy (repair or replace) should contain a "fall back" provision for return of money.

6. *Statute of limitations*. 2A-715. As ELA requested, a "discovery" rule governs the start of the 4-year statute of limitations in 2A. The Comment recognizes one of the differences between leases and sales: "Breach of warranty and indemnity claims often arise in a lese transaction; with the passage of time such claims often diminish or are eliminated. To encourage the parties to commence litigation under these circumstances makes little sense. Therefore, the ability to extend the limitations period is particularly valuable in the lease context."

7. *Remedial promise*. This concept will be stricken from 2A. Two discussion points. ***First*** (White): If sections on "remedial promises" stayed in, and repair or replace clauses triggered a lengthened statute of limitations period, the impact would be that sellers would not write agreed remedies into their contracts. This would be a loss to society. Benfield/Miller/White: There is a distinction

between (a) "I'll repair your roof for 30 years" and (b) a repair or replace clause triggered (if at all) at time of delivery. In 2A leases, the end of the lease term puts a boundary on the length of the lessor's exposure. ***Second:*** Odd cases might involve the situation where (a) the cost of repair exceeds (b) the loss of value in the goods. Suppose the contract says "Paint my house purple," and the painter paints it white instead. Here the "breach" made the house more valuable than proper performance. What would the buyer want here as its measure of damages?

B. Lessor's Remedies

Electronic self-help. This issue was very controversial in 2B. We declined the invitation to accept a statutory section in 2A that would have highly regulated "electronic self-help." Electronic self-help (or electronic disabling) is more likely to arise in software transactions than in equipment leasing: Equipment leasing looks more to default and repossession--as opposed to electronic disabling-- as a remedy for non-payment of rent or misuse of the equipment.

Hypotheticals that were discussed in March included: (1) stolen autos on their way to Mexico; (2) satellite disabling of rented cars/ships/(planes?) straying outside "permitted" territory. Contrast: (A) Electronic disabling of a dangerous use by anyone (e.g., power tool shuts down automatically), whether leased or not, if anyone tries to remove safety guard. (B) Under new 2A-718 (old 2A-525), the lessor is allowed to disable equipment left in the lessee's possession after a lessee default. Compare proposed new 2A-502 (expanded implied warranty of quiet enjoyment). The issue was left to the common law.

C. Lessee's Remedies

Lessor's right to cure. 2A-729; current 2A-513. There is a modest expansion of the lessor's right to cure after the time for delivery has passed: "the lessor or supplier, upon seasonable notice to the lessee and at its own expense, may cure a default, if the cure is appropriate and timely under the circumstances, by making a tender of conforming goods." New 2A-729(b).

CONCLUSION

Other issues were raised *in abundance* by the proposed revisions to UCC Article 2A-Leases. These were discussed in other ELA comments and are not rehashed here.

Our view is that proposed revised 2A-leases still needs significant refinement. Two coming forums for discussion and improvement of 2A-leases are the May 1999 ALI meeting in San Francisco, and the July 22nd 2A Committee meeting in Denver.

Best regards.

April 27, 1999 EDWIN E. HUDDLESON, III